

DEPARTMENT OF STATE REVENUE

**LETTER OF FINDINGS NUMBER: 97-0543 ITC
GROSS INCOME TAX
For Years 1994, 1995 AND 1996**

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Gross Income Tax – Employee Salaries

Authority: 45 IAC 1-1-54; IC 6-2.1-1-11 (2); Universal Group Limited, et.al. v. Indiana Department of State Revenue; 642 N.E. 2d 553; (Ind. Tax Ct. 1994)

Taxpayer maintains arrangement between parent and subsidiary corporation, where parent corporation pays subsidiary's employees directly for services performed for the parent corporation, constitutes reimbursements in an agency relationship with the parent and is thus exempt from gross income tax.

II. Gross Income Tax – Payroll Tax Reimbursement.

Authority: 45 IAC 1-1-54; Universal Group Limited, et.al. v. Indiana Department of State Revenue; 642 N.E. 2d 553; (Ind. Tax Ct. 1994)

Taxpayer maintains arrangement between parent and subsidiary corporation, where parent corporation pays subsidiary reimbursement for subsidiary's employee's payroll taxes on the employee's salary for services performed for the parent corporation, is exempt from gross income tax based on an agency relationship between parent and subsidiary corporation.

STATEMENT OF FACTS

Taxpayer, a for-profit subsidiary corporation of a not-for-profit hospital (parent corporation), selected and hired employees for physician support services at the hospital and its affiliates. Taxpayer paid employee payroll and unemployment taxes while the parent corporation paid the taxpayer employees directly from parent corporation accounts. Taxpayer was assessed taxes based on both the money paid to the employees and the money paid it for tax payments and appeals based on the exemption from gross income tax for income received in an agency capacity.

I. Gross Income Tax – Employee Salaries

DISCUSSION

45 IAC 1-1-54 provides an exemption from the gross receipts tax for agents that receive income in an agency capacity. The exemption has two requirements that must be met for the exemption to apply. The relevant requirement to be considered is found at 45 IAC 1-1-54 (2):

The agent must have no right, title or interest in the money or property received or transferred as an agent. In other words, the income received for work done or services performed on behalf of a principal must pass intact to the principal or a third party; the agent is merely a conduit through which the funds pass. A contractual relationship whereby one person incurs expense under an agreement to be reimbursed by another is not an agency relationship unless the other elements of agency exist, particularly the element of control, discussed above.

In Universal Group Limited, et.al. v. Indiana Department of State Revenue 642 N.E. 2d 553 at 555-556, the Tax Court of Indiana restated the rule of law on agent reimbursements:

The lesson of Ice Service, Associated Telephone, and Western Adjustment, as discussed in UGL I, is that there is no gross income tax liability for an agent when: 1) the agent, acting in an agency capacity, receives income in which the agent has no right, title, or interest, and; 2) the agent subsequently “passes through” the income to a principal or a third party. UGL I, 609 N.E.2d at 51-54.

This case summarizes the requirements of 45 IAC 1-1-54 to include the conduit activity (passing through) of the income by the party claiming agency.

Granting, for purposes of this discussion only, that the taxpayer is an agent for the parent corporation and that the payment by the parent corporation of the wages due the taxpayer's employees would be money that the taxpayer would have no "right, title or interest in," the taxpayer still receives the benefit of a debt (to its employees) being paid- qualifying as taxable gross receipts in IC 6-2.1-1-11 (2). Consequently, taxpayer fails to qualify for the agency exemption granted in 45 IAC 1-1-45 and restated in Universal Group Limited, 642 N.E. 2d 553, exempting the taxpayer only when receiving and passing payments through to a third party without taxpayer benefit. Given taxpayer's failure to meet this qualification, no discussion or finding is necessary related to taxpayer's status as an agency in its relationship to its parent corporation.

FINDINGS

Taxpayer appeal denied.

II. Gross Income Tax – Payroll Tax Reimbursement

DISCUSSION

45 IAC 1-1-54 provides an exemption from the gross receipts tax for agents that receive income in an agency capacity. The exemption has two requirements that must be met for the exemption to apply. Again, the primary requirement to be considered is found at 45 IAC 1-1-54 (2):

The agent must have no right, title or interest in the money or property received or transferred as an agent. In other words, the income received for work done or services performed on behalf of a principal must pass intact to the principal or a third party; the agent is merely a conduit through which the funds pass.

In Universal Group Limited, et.al. v. Indiana Department of State Revenue, 642 N.E. 2d 553 at 555-556, as cited above, the rule on agent reimbursements was restated as:

The lesson of Ice Service, Associated Telephone, and Western Adjustment, as discussed in UGL I, is that there is no gross income tax liability for an agent when: 1) the agent, acting in an agency capacity, receives income in which the agent has no right, title, or interest, and; 2) the agent subsequently "passes through" the income to a principal or a third party. UGL I, 609 N.E.2d at 51-54.

Both the code and the case emphasize the agent must have no interest, right, or title to the income thus transferred, and emphasis is placed on the conduit or “pass through” aspect, the agent acting merely to transfer funds without agent benefit.

While taxpayer argues extensively, and persuasively, that the parent corporation would be accountable for various taxes and civil rights violations should it authorize the subsidiary corporation to violate tax and civil rights laws, taxpayer presents no evidence that the payment of expenses related to its employees is something taxpayer would have no right, title, or interest in. Indeed, among taxpayer’s arguments it is stated:

Withholding tax: If [Parent Corporation] or its employees were to stop reimbursing [Subsidiary Corporation] for withholding tax and authorize [Subsidiary corporation] to stop withholding tax on the [Subsidiary corporation] employees, [Parent corporation] or its employees could be considered “responsible” persons for the withholding tax penalty under 26 U.S.C.: 6672. If an individual is concurrently employed by two or more related corporations and all remunerations is [sic] disbursed to the individual through a common paymaster for the group, the common paymaster is responsible for reporting and payment of the taxes, but the other related corporation remains jointly and severally liable for their appropriate share of the taxes. 26 C.F.R. 31.3121(s)-1.

As taxpayer states, the subsidiary corporation is responsible for payment of the taxes, while the parent corporation could be also held accountable for a failure to pay, it in no way negates the benefit to taxpayer in the payment of a tax for which it is legally accountable. If the parent corporation were to refuse to reimburse taxpayer for services rendered by taxpayer’s employees, taxpayer would have the right to take legal action against the parent corporation.

Again, granting agency status to the taxpayer for this discussion only, for the gross receipts agency exemption to apply the code and case law require the agency to have no right, title, or interest in the income- to merely serve as a conduit for the money to “pass through.” Evidence given by the taxpayer clearly confirms the logical inference that, as an employer, taxpayer corporation has an obligation for its employee’s taxes. As stated by taxpayer, the parent corporation has a legal obligation to pay for services rendered by employees- in this case parent corporation is obligated to pay taxpayer for services provided by taxpayer employees- and parent corporation’s failure to make these payments would result in liability to taxpayer corporation. Given taxpayer’s right to claim these funds from the parent corporation, taxpayer has failed to meet the agency exemption requirement to merely serve as the conduit for parent corporation funds, the agency exemption does not apply and no discussion or finding is necessary related to taxpayer’s status as an agency in its relationship to its parent corporation.

FINDINGS

Taxpayer appeal denied.